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SUBJECT: ECONOMIC SNAPSHOT OF EU ENLARGEMENT FOR UK

#### SUMMARY AND COMMENT

**¶1.** Since Romania and Bulgaria formally joined the European Union (EU) on January 1, 2007, we have witnessed increased reference to economic activity between the UK and the new member states, ranging from high level visits to various UK contacts indicating they have purchased vacation property in the region. A closer look at trade and investment flows indicates the change in the economic relationship started back in 1999 when the EU agreed to begin accession negotiations with both countries. The anticipated economic reforms leading up to EU membership created an attractive market for UK trade and investment. Anecdotal evidence appears to indicate that formal accession on January 1 has not had a similar impact on the UK economy, although it is still early in the process.

**¶2.** British companies are already among the leaders in foreign direct investment in both countries, and UK trade with each country, while still relatively small, has grown significantly since 1999. Bulgaria, in particular, has moved to enhance ties with the UK in 2007, including a visit by Prime Minister Stanishev to London and a visit of the UK's Deputy Prime Minister Prescott to Bucharest; while His Royal Highness (HRH) Prince Charles has helped highlight British investment in real estate in Romania. Further UK ties with Romania and Bulgaria have been enhanced by visa free travel, partner city arrangements, and UK bilateral assistance aimed at supporting EU integration. We are yet to see whether the increased activity will bear economic fruit for the UK. This cable is only a snapshot of economic activity and does not reflect a comprehensive report on the economic costs and benefits of enlargement.

#### INCREASED TRADE FLOWS

**¶3.** UK trade (exports plus imports) with Romania and Bulgaria grew by almost 200 percent from 1999 to 2006. In comparison, UK trade with the other 25 EU member states increased by 63 percent during the same period. Trade with Romania increased by almost GBP 1 billion since 1999 to GBP 1.473 billion (USD 2.8 billion) in 2006. Most of the growth in UK-Romanian trade took place from 1999 to 2004, averaging 23 percent per year. Trade in 2005 and 2006 slowed significantly to only 2.7 percent per year and has continued at this lower rate during the first two months of 2007. According to Romanian Embassy officials, much of the increased trade activity leading up to EU accession calmed down after the end of EU negotiations in December 2004. Overall, the UK has a growing trade deficit with Romania as exports remain stable and imports, primarily textile and electrical parts, continue to grow.

**¶4.** From 1999 to 2006, UK trade with Bulgaria increased at a similar rate per year (16.8 percent) to that with the much larger Romania (16.9 percent). However, Bulgaria has avoided Romania's recent slowdown with increases of 27.5 percent in 2005 and 10.8 percent in 2006. The UK has a small trade

surplus with Bulgaria, led by British exports of machinery, medicinal and pharmaceutical products, and telecommunications equipment. While still small, UK trade with Bulgaria nearly doubled as a proportion of UK trade with the entire EU from 1999 (0.07 percent) to 2006 (0.13 percent). Despite the impressive growth, combined UK trade with Bulgaria and Romania remains well below 1 percent of UK trade with the expanded 27 member European Union.

#### ONE WAY INVESTMENT

¶ 15. UK investment in Romania to date is dominated by large infrastructure, financial services, and privatization projects, highlighted by Vodafone's acquisition of the mobile network operator Connex in 2005 for 2.5 million euro in the biggest deal in Romanian history. Large UK retailers have invested in small and medium sized enterprises (SMEs) for textile manufacturing, but UK businesses have otherwise lagged behind other European countries in regards to linking with Romanian SMEs. One area that has increased sharply since EU accession, according to Romanian Embassy officials in London, is UK investment in both commercial and residential real estate. Our contact passed some credit for the recent increased interest in Romania to HRH Prince Charles who purchased a house in Transylvania at the end of 2006 and is the royal patron to a trust set up to restore the cultural heritage of the area's Saxon villages. Our Romanian contact also cited a few recent examples of British firms relocating their call centers from India to take advantage of the many European languages spoken in Romania.

¶ 16. The UK was the third largest foreign investor in Bulgaria in 2005, and more than doubled that investment in the first nine months of 2006. UK investment is focused on the oil and

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gas sector, real estate, and property development. Since joining the EU, Bulgarian officials and businesses have flooded the UK with forums, seminars and speeches aimed at encouraging more foreign direct investment. Prime Minister Stanishev touted Bulgaria's economic growth and reunification with Europe in speeches at a prominent London university and a well-attended investment seminar at the European Bank for Reconstruction and Development (EBRD). At the EBRD event, Minister of Economy and Energy Ovcharov pointed investors towards the energy, transport, infrastructure, and tourism sectors. The EBRD and risk management consultants praised Bulgaria's macroeconomic stability and new, low corporate tax rate, but also warned UK businesses that political, legal and administrative challenges remain.

¶ 17. For both Romania and Bulgaria, the investment seems to flow in one direction. There is little evidence that Romanian or Bulgarian investors have targeted the high-priced UK market. This investment may also be constrained by the UK opting for the first time to restrict working permits for citizens of the newest EU member states.

#### FURTHER TIES

¶ 18. Bulgaria Prime Minister Sergey Stanishev told students and journalists at the London School of Economics and Political Science (LSE) on February 8, 2007 that reunification with a "free, democratic and prosperous" Europe through joining the EU represented the final fall of the Berlin Wall for Bulgaria. He said the difference is tangible for Bulgarians in that just seven years ago they had to wait in long queues for visas to travel to other European countries. Upon entry into the EU on January 1, 2007, Bulgarians (and Romanians) can now travel visa free to every member state, including the UK (although restrictions remain on work permits in the UK). In the case of Romania, EU accession has also revived partner city campaigns, including enhanced bilateral investment and tourism between Leeds, the third largest city in the UK, and Brasov in Romania.

¶9. The UK also provides bilateral assistance to Romania and Bulgaria through the Foreign and Commonwealth Office's Global Opportunities Fund (GOF). The GOF's Reuniting Europe Program is scheduled this year to award GBP 650,000 (USD 1.3 million) and GBP 500,000 (USD 1 million) towards projects in Romania and Bulgaria, respectively. The Reuniting Europe Program focuses on promoting transparency and accountability and building administrative capacity for EU integration. In 2006/2007, the emphasis of GOF projects in both countries was on justice and home affairs, regional economic development, administrative capacity and creation of a pro-business environment.

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